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February 6, 2023

Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

***Re: Docket No. R–1786 and RIN 7100–AG44***

Board of Directors
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

***Re: RIN 3064–AF86***

Dear officers,

On behalf of more than 500,000 members and supporters of Public Citizen , we offer the following comment on this advance notice of proposed rulemaking (ANPRM) regarding whether an extra layer of what the agencies call "loss-absorbing capacity" could improve the "options" when large banking organization fail.[1] The agencies' stated goal of the ANPRM is to address bank failure so that when it happens to an institution, there would better guardrails to limit the "contagion risk through the reduction in the likelihood of uninsured depositors suffering loss," and to maximize options for the Federal Deposit Insurance Corporation (FDIC) so that it minimizes "the long term risk to financial stability."

In this ANPRM, the agencies focus on a proposal to add an additional layer of debt as the central tool to optimizing resolution protocols should the banking institution fail. We believe this is the wrong approach. The correct approach is to require additional capital. Already, the largest banks are highly leveraged, financing their assets with more than 94 percent in debt, and only a little more than 5 percent with equity capital. This means that if their assets were to devalue by 6 percent, such as from a recession that drives mortgage defaults or increased bad credit card debt, then the

[1] Federal Reserve, Resolution-Related Resource Requirements for Large Banking Organizations, Federal Register, (Oct. 24, 2022) https://www.govinfo.gov/content/pkg/FR-2022-10-24/pdf/2022-23003.pdf

bank becomes insolvent. As Thomas Hoenig, former board member of the FDIC and now a George Mason University professor, noted, "Adding leverage to the banking system in the expectation that it enhances financial stability is a gamble. Equity funding enhances resiliency, which is the goal of regulation and supervision."[2]

Therefore, instead of further overleveraging of our financial institutions, we believe that the agencies should propose a rule that would place additional accountability measures on the very management team responsible for driving a large banking firm into insolvency. There is no better place to establish such discipline than the banker's paycheck. A significant portion of senior banker pay, such as half of a compensation package that exceeds $1 million, should be sequestered into a fund and not paid to that executive for 10 years. (Ten years is the statute of limitation for the Financial Institutions Reform, Recovery and Enforcement Act, a period considered necessary given that banking problems can take years to decipher.) Further, a substantial portion of this pay can be in debt that converts to equity should the firm declare insolvency. That equity would likely be nearly worthless at that time, and the bank would be absolved from that debt. Given that banker pay for senior officers can be substantial, this newly absolved debt could be substantially liberating for the now insolvent bank, making resolution easier. We note that deferring banker pay for penalties became a prominent idea for reform with the speech of a Federal Reserve System leader.[3]

Further, we welcome the comments of Comptroller of the Currency, Michael Hsu, regarding whether some banks are "too big to manage." He noted that "there are limits to an organization's manageability. . . . [and there] is a growing body of evidence to support this premise. Enterprises can become so big and complex that control failures, risk management breakdowns, and negative surprises occur too frequently – not because of weak management, but because of the sheer size and complexity of the organization."[4] Public Citizen explored this subject as well.[5] Regulators who weigh whether they can successfully resolve the failure of a megabank should take preemptive actions by breaking up those they believe are already "too big to manage." This will require regulatory fortitude and we are encouraged that the Comptroller (who serves on the FDIC board) has stepped up publicly to highlight that it will deploy this tool where it finds such circumstances.

Finally, we believe any improved options in the resolution of a failed bank should be modelled specifically so as not create an even larger mega-bank, as happened with the failure of Washington Mutual—sold to behemoth JP Morgan; or Wachovia—sold to giant Wells Fargo. Surely, size alone challenges the ability of the FDIC to maintain financial stability amidst such a failure.

Again, we reiterate that we oppose adding debt as a means of increasing options for the resolution of a large bank that fails.

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[2] Letter, Thomas Hoenig, FDIC, (Dec. 15, 2022) https://www.govinfo.gov/content/pkg/FR-2022-10-24/pdf/2022-23003.pdf

[3] Bartlett Naylor, Decimate Wall Street, Huffington Post (Oct. 22, 2014) https://www.huffpost.com/entry/decimate-wall-street_b_6029372

[4] Michael Hsu, *Detecting, Preventing, and Addressing Too Big To Manage,* BROOKINGS INSTITUTION (Jan. 17, 2023) https://subscriber.politicopro.com/f/?id=00000185-c0b7-d638-a3bf-d6bf9ba10000&source=email

[5] Bartlett Naylor, TOO Big, Public Citizen (2016) https://www.citizen.org/wp-content/uploads/toobig.pdf

For questions, please contact Bartlett Naylor at .

Sincerely,

Public Citizen